

PERFORMANCE AUDIT
OF THE
SPECIALIZED RESIDENTIAL SERVICES PROGRAM
OF RESIDENTIAL CARE ALTERNATIVES, INC.

AN AGENCY UNDER CONTRACT WITH THE
DETROIT-WAYNE COUNTY
COMMUNITY MENTAL HEALTH AGENCY

April 1999

EXECUTIVE DIGEST

SPECIALIZED RESIDENTIAL SERVICES PROGRAM OF RESIDENTIAL CARE ALTERNATIVES, INC.

INTRODUCTION	This report, issued in April 1999, contains the results of our performance audit* of the Specialized Residential Services Program of Residential Care Alternatives, Inc. (RCA), an agency under contract with the Detroit-Wayne County Community Mental Health Agency* (DWCCMHA).
AUDIT PURPOSE	This performance audit was conducted as part of the constitutional responsibility of the Office of the Auditor General. Performance audits are conducted on a priority basis related to the potential for improving effectiveness* and efficiency*.
BACKGROUND	RCA, located in Detroit, Michigan, is a nonprofit mental health agency under contract with DWCCMHA to provide mental health services to adults with mental illnesses* and developmental disabilities* throughout Wayne County. RCA provides direct outpatient*, home development, residential placement, case management*, day program*, and supported employment services* and it subcontracts for specialized residential services* . RCA is governed by a five-member board of trustees selected from Southeastern Michigan.

* See glossary on page 28 for definition.

RCA's mission* is to provide a residential alternative to the institutionalization of persons with disabilities through the development of specialized treatment programs designed to enhance their daily living skills, self-reliance, and successful residency in the community.

RCA's operations are funded by State, federal, and local funds. As of September 30, 1996, RCA had 119 employees and was serving over 800 recipients*. For fiscal year 1995-96, RCA's revenues and expenditures totaled \$30,826,170 and \$30,770,160, respectively. As a provider of specialized residential services, RCA subcontracted with 96 residential homes as of September 30, 1996. For fiscal year 1995-96, RCA's expenditures for its specialized residential services program totaled \$23,642,552.

**AUDIT OBJECTIVES,
CONCLUSIONS, AND
NOTEWORTHY
ACCOMPLISHMENTS**

Audit Objective: To assess the effectiveness of the specialized residential services contract administration process.

Conclusion: We concluded that RCA's contract administration process for specialized residential services was not effective for the 11 homes that we reviewed. Our assessment disclosed two material conditions* :

- RCA did not effectively monitor home provider* reported expenditures for contract compliance (Finding 1).

RCA concurs with the corresponding recommendation and informed us that it has initiated corrective action.

* See glossary on page 28 for definition.

- RCA often did not establish home provider repayment plans that complied with contractual provisions and DWCCMHA instructions for repaying amounts due based on audits and cost settlements (Finding 2).

RCA concurs with the corresponding recommendation and informed us that it has initiated corrective action.

In addition, our audit disclosed two other material conditions that impacted the effectiveness of RCA's contract administration process. These two material conditions are reported under our second audit objective.

Noteworthy Accomplishments: RCA informed us that it increased the number of its specialized residential homes that the Department of Community Health or the Department of Consumer and Industry Services certified to operate as a specialized program for adults with mental illnesses or developmental disabilities. As of November 1994, RCA had none of its 96 homes certified in accordance with the State certification process that began during 1994. However, by November 1996, RCA had 39 (41%) of its 96 homes certified and, by November 1997, RCA had 93 (97%) of its 96 homes certified. The certification process examines the homes' compliance with standards set forth in the *Michigan Administrative Code* for the placement of adults who have a mental illness or a developmental disability into community-based dependent living settings.

Also, RCA informed us that it was granted a three-year renewal of its accreditation by the Rehabilitation Accreditation Commission* (CARF) in 1995 and again in 1998. CARF is a nationally recognized accrediting

* See glossary on page 28 for definition.

authority, which established standards of quality for services provided to people with disabilities. Programs with CARF accreditation demonstrate substantial compliance with CARF standards.

Audit Objective: To assess whether State funds were used effectively and efficiently in the purchase and delivery of specialized residential services.

Conclusion: We concluded that State funds were not used effectively and efficiently in the purchase and delivery of specialized residential services for the 11 homes that we reviewed. Our assessment disclosed two material conditions:

- RCA did not review the subcontracts entered into by its home providers for specialized residential services to determine that the subcontracts were appropriate and complied with RCA requirements (Finding 3).

RCA concurs with the corresponding recommendations and informed us that it has initiated corrective action.

- RCA was not effective in detecting erroneous financial reporting by home providers contracted to deliver specialized residential services (Finding 4).

RCA concurs with the corresponding recommendations and informed us that it has initiated corrective action.

**AUDIT SCOPE AND
METHODOLOGY**

Our audit scope was to examine the program and other records of the Specialized Residential Services Program of Residential Care Alternatives, Inc. Our audit was conducted in accordance with *Government Auditing*

Standards issued by the Comptroller General of the United States and, accordingly, included such tests of the records and such other auditing procedures as we considered necessary in the circumstances.

We examined RCA's records and activities related to 11 of RCA's 96 residential homes for the two contract years beginning October 1, 1994 and ending September 30, 1996. The 11 homes that we selected for the audit were not chosen randomly. The homes were selected based on their history of prior Department of Community Health and public accounting firm audit exceptions and the potential risk that the conditions that led to those prior audit exceptions were not corrected.

To accomplish our audit objectives, we reviewed DWCCMHA's annual contract with RCA and RCA's annual contracts with its home providers. We obtained and reviewed DWCCMHA's and RCA's policies and procedures. We interviewed RCA and residential home provider personnel. We reviewed and evaluated RCA's efforts to monitor residential home provider compliance with RCA's contracts. We examined and assessed RCA's processes to resolve contract disputes and collect amounts due based on residential home provider audits and cost settlements. We examined and evaluated RCA's methods for ensuring the accuracy and propriety of residential home provider reported revenues and expenditures. We examined the financial records of select residential home providers. We evaluated RCA's and residential home providers' utilization of State funds in delivering specialized residential services.

AGENCY RESPONSES

Our audit report contains 4 findings and 6 corresponding recommendations. RCA's preliminary response indicated that it concurs with all 6 recommendations.

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Mr. Ronald Rice, Chairman
Residential Care Alternatives, Inc.
8045 Second Avenue
Detroit, Michigan
and
Ms. Cynthia Taueg, Chairperson
Detroit-Wayne County Community Mental Health Agency
640 Temple, 8th Floor
Detroit, Michigan
and
Mr. James K. Haveman, Jr., Director
Department of Community Health
Lewis Cass Building
Lansing, Michigan

Dear Mr. Rice, Ms. Taueg, and Mr. Haveman:

This is our report on the performance audit of the Specialized Residential Services Program of Residential Care Alternatives, Inc., an agency under contract with the Detroit-Wayne County Community Mental Health Agency.

This report contains our executive digest; description of agency; audit objectives, scope, and methodology, and agency responses; comments, findings, recommendations, and agency preliminary responses; exhibits, presented as supplemental information; and a glossary of acronyms and terms.

Our comments, findings, and recommendations are organized by audit objective. The agency preliminary responses were taken from the agency's responses subsequent to our audit fieldwork.

We appreciate the courtesy and cooperation extended to us during this audit.

Sincerely,

Thomas H. McTavish, C.P.A.
Auditor General

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Description of Agency

Residential Care Alternatives, Inc. (RCA), located in Detroit, Michigan, is a nonprofit mental health agency under contract with Detroit-Wayne County Community Mental Health Agency (DWCCMHA) to provide mental health services to adults with mental illnesses and developmental disabilities throughout Wayne County. RCA provides direct outpatient, home development, residential placement, case management, day program, and supported employment services and it subcontracts for specialized residential services. RCA is governed by a five-member board of trustees selected from Southeastern Michigan.

RCA's mission is to provide a residential alternative to the institutionalization of persons with disabilities through the development of specialized treatment programs designed to enhance their daily living skills, self-reliance, and successful residency in the community.

RCA's operations are funded by State, federal, and local funds. As of September 30, 1996, RCA had 119 employees and was serving over 800 recipients. For fiscal year 1995-96, RCA's revenues and expenditures totaled \$30,826,170 and \$30,770,160, respectively. As a provider of specialized residential services, RCA subcontracted with 96 residential homes as of September 30, 1996. For fiscal year 1995-96, RCA's expenditures for its specialized residential services program totaled \$23,642,552.

Audit Objectives, Scope, and Methodology and Agency Responses

Audit Objectives

Our performance audit of the Specialized Residential Services Program of Residential Care Alternatives, Inc. (RCA), an agency under contract with the Detroit-Wayne County Community Mental Health Board (DWCCMHA), had the following objectives:

1. To assess the effectiveness of the specialized residential services contract administration process.
2. To assess whether State funds were used effectively and efficiently in the purchase and delivery of specialized residential services.

Audit Scope

Our audit scope was to examine the program and other records of the Specialized Residential Services Program of Residential Care Alternatives, Inc. Our audit was conducted in accordance with *Government Auditing Standards* issued by the Comptroller General of the United States and, accordingly, included such tests of the records and such other auditing procedures as we considered necessary in the circumstances.

Audit Methodology

Our audit work was performed during the months of January 1997 through August 1998 and included examining RCA's records and activities related to 11 of RCA's 96 residential homes for the two contract years beginning October 1, 1994 and ending September 30, 1996. The 11 homes that we selected for the audit were not chosen randomly. The homes were selected based on their history of prior Department of Community Health and public accounting firm audit exceptions and the potential risk that the conditions that led to those prior audit exceptions were not corrected.

To accomplish our first objective, we reviewed DWCCMHA's annual contract with RCA. We obtained and reviewed DWCCMHA's and RCA's policies and procedures. We interviewed RCA personnel. We evaluated RCA's contract development and budgeting process used to procure specialized residential services. We reviewed and evaluated

RCA's efforts to monitor residential home provider compliance with RCA's contracts. We examined and assessed RCA's processes to resolve contract disputes and collect amounts due based on residential home provider audits and cost settlements.

To accomplish our second audit objective, we reviewed RCA's annual contracts with its residential home providers. We interviewed RCA and residential home provider personnel. We assessed residential home providers' purchasing practices to procure specialized residential services. We obtained and reviewed quarterly and annual revenue and expenditure reports submitted to RCA by its residential home providers. We examined and evaluated RCA's methods for ensuring the accuracy and propriety of residential home provider reported revenues and expenditures. We examined the financial records of select residential home providers. We evaluated RCA's and residential home providers' utilization of State funds in delivering specialized residential services.

Agency Responses

Our audit report contains 4 findings and 6 corresponding recommendations. RCA's preliminary response indicated that it concurs with all 6 recommendations.

RCA's preliminary response which follows each recommendation in our audit report was taken from RCA's written comments and oral discussion subsequent to our fieldwork.

COMMENTS, FINDINGS, RECOMMENDATIONS, AND AGENCY PRELIMINARY RESPONSES

CONTRACT ADMINISTRATION

COMMENT

Background: The Detroit-Wayne County Community Mental Health Agency (DWCCMHA) contracts with Residential Care Alternatives, Inc. (RCA), to provide specialized residential services to mental health recipients within Wayne County. To fulfill its contractual obligation, RCA subcontracts with 96 residential homes to provide room and board, 24-hour supervision and protection, and mental health services.

Audit Objective: To assess the effectiveness of the specialized residential services contract administration process.

Conclusion: We concluded that RCA's contract administration process for specialized residential services was not effective for the 11 homes that we reviewed. Our assessment disclosed two material conditions. RCA did not effectively monitor home provider reported expenditures for contract compliance. Also, RCA often did not establish home provider repayment plans that complied with contractual provisions and DWCCMHA instructions for repaying amounts due based on audits and cost settlements.

In addition, our audit disclosed two other material conditions that impacted the effectiveness of RCA's contract administration process. These two material conditions are reported under our second audit objective.

Noteworthy Accomplishments: RCA informed us that it increased the number of its specialized residential homes that the Department of Community Health or the Department of Consumer and Industry Services certified to operate as a specialized program for adults with mental illnesses or developmental disabilities. As of November 1994, RCA had none of its 96 homes certified in accordance with the State certification process that began during 1994. However, by November 1996, RCA had 39 (41%) of its 96 homes certified and, by November 1997, RCA had 93 (97%) of its 96 homes

certified. The certification process examines the homes' compliance with standards set forth in the *Michigan Administrative Code* for the placement of adults who have a mental illness or a developmental disability into community-based dependent living settings.

Also, RCA informed us that it was granted a three-year renewal of its accreditation by the Rehabilitation Accreditation Commission (CARF) in 1995 and again in 1998. CARF is a nationally recognized accrediting authority, which established standards of quality for services provided to people with disabilities. Programs with CARF accreditation demonstrate substantial compliance with CARF standards.

FINDING

1. Monitoring of Reported Expenditures

RCA did not effectively monitor home provider reported expenditures for contract compliance.

The DWCCMHA contract with RCA requires RCA to comply with all reasonable requests from DWCCMHA. DWCCMHA requires RCA to monitor and review home provider reported expenditures each quarter and at the end of each annual contract period to the extent necessary to help ensure home provider contract compliance.

We reviewed records for home provider monitoring reviews that RCA conducted through June 30, 1997 for fiscal year 1994-95 and 1995-96 reported expenditures. Although RCA had collected quarterly and annual expenditure reports from its home providers, we found that RCA had not conducted any quarterly and annual reviews of these expenditures to assess and ensure compliance with RCA's contracts.

Our audit noted many instances of noncompliance related to excessive administrative fees and undocumented and misrepresented expenditures by home providers that totaled \$1,263,236 in questioned costs* (see Exhibit 1). The instances of noncompliance that our audit noted are similar to those cited by the

* See glossary on page 28 for definition.

Department of Community Health (DCH) in its audit of RCA and its home providers for fiscal year 1990-91 (report issued in December 1994) and by several CPA firms' audits of RCA's home providers for fiscal years 1991-92 and 1992-93 (reports issued in 1993 and 1994, respectively). In addition, the DCH audit attributed home provider noncompliance, in part, to RCA's lack of financial monitoring of its home providers.

We conclude that RCA could detect in a timely manner such instances of noncompliance and help prevent them from occurring in the future if it effectively monitored home provider reported expenditures. Monitoring that includes regularly comparing reported expenditures to budgets and investigating any significant differences, verifying selected reported expenditures to invoices and other supporting documentation, and reviewing selected payroll records would help RCA ensure contract compliance. This is especially important given the home providers' history of reporting expenditures to RCA that are not eligible for reimbursement under RCA's contracts.

RECOMMENDATION

We recommend that RCA effectively monitor home provider reported expenditures for contract compliance.

AGENCY PRELIMINARY RESPONSE

RCA concurs with the recommendation. RCA informed us that it has implemented procedures for reviewing home provider revenue and expenditures that include the monitoring of revenue and expenditure reports submitted to RCA on a quarterly and annual basis, desk audits performed by RCA contract managers, and comprehensive financial audits of home provider records. RCA has hired contract management staff and adopted new computerized procedures to help perform these functions. Also, DWCCMHA has returned the comprehensive financial audit function back to RCA to help improve its monitoring system. RCA was not responsible for the financial audit function during the audit period.

FINDING

2. Collection of Amounts Due Based on Audits and Cost Settlements

RCA often did not establish home provider repayment plans that complied with contractual provisions and DWCCMHA instructions for repaying amounts due based on audits and cost settlements.

RCA's contracts with its home providers require them to repay amounts due based on audits and cost settlements within 30 days. The contracts stipulate that a home provider may negotiate an agreement with RCA to extend the length of repayment to 12 months if the 30-day repayment period would result in a financial hardship to the home provider. If a home provider fails to keep this commitment, RCA is to assess a 7% annual interest rate until the debt is repaid. DWCCMHA instructions modify this requirement and allow the home provider to renegotiate the agreement with RCA to extend the repayment period up to a maximum of 5 years for amounts due under \$20,000 and 10 years for amounts due over \$20,000. RCA collects the amounts owed by its home providers by withholding a portion of the home provider's monthly contract payment.

As of September 30, 1996, 65 residential homes owed RCA \$4,565,283 from prior fiscal year audits and cost settlements. The amounts owed resulted from the home providers receiving reimbursement for unallowable and undocumented expenditures that the audits and cost settlements identified. We analyzed the repayment records for 8 of the 11 homes that we reviewed which had outstanding balances due to RCA. The following table demonstrates that RCA established repayment plans that violated RCA contract requirements and DWCCMHA

instructions for all 8 residential homes because they exceeded 10 years and/or did not assess a 7% annual interest rate on the unpaid balance:

Scheduled Repayment of Balances Due by Residential Home
As of September 30, 1996

Residential Home	Balance Due	Scheduled Monthly Repayment	Interest Assessed	Remaining Years to Pay Off Balance	Present Value of Repayments*	Present Value of Repayments as a Percentage of Balance Due
1	\$ 118,407	\$ 550	\$ 0	18	\$ 67,870	57%
2	142,570	550	0	22	74,050	52%
3	72,047	350	0	17	42,255	59%
4	268,533	200	0	112	34,668	13%
5	146,505	200	0	61	34,183	23%
6	58,039	1,126	0	4	50,714	87%
7	61,737	0	0	Indefinite	0	0%
10	70,765	350	0	17	41,824	59%
	<u>\$938,602</u>	<u>\$3,326</u>	<u>\$ 0</u>		<u>\$ 345,564</u>	<u>37%</u>

* The present value was calculated using a 7% annual interest rate. The present value is the total amount that a series of future payments is worth now. For example, when a person borrows money, the loan amount is the present value to the lender.

Also, as the table illustrates, most of the home repayment plans do little to recover the balances owed. For example, RCA established a repayment plan for residential home 4 that will take 112 years to complete. It is questionable whether RCA will recover all \$268,533 owed over such a lengthy time period. Even if RCA recovers the total balance owed over 112 years, the present value of these repayments is \$34,668 or \$0.13 on the dollar. We conclude that these collection efforts are ineffective.

RCA received six different sets of instructions from DWCCMHA between October 20, 1995 and September 16, 1996 concerning allowable repayment periods and plans for home providers. Each new set of instructions changed or reversed the criteria previously provided to RCA for determining the repayment amount or period. RCA management informed us that RCA's contract managers may have unintentionally erred in establishing or accepting home provider repayment terms contrary to final DWCCMHA instructions because of the

numerous and sometimes conflicting instructions received. However, DWCCMHA's various instructions to RCA never provided for repayment periods that exceeded 10 years, which was what we found for 7 of the 8 repayment terms that we analyzed.

RCA management also informed us that it did not withhold the amounts required by DWCCMHA from these home providers' monthly payments because of management's concern that the home providers may not have sufficient funds to continue to operate. However, our audit showed that these 8 home providers had a continued history of reporting expenditures to RCA that were not eligible for reimbursement (see Finding 1). RCA's practice of not aggressively seeking to recover the amounts owed may have contributed to this trend of contract noncompliance. Ineffective collection efforts could discourage home providers from correcting practices of reporting excessive, undocumented, and unallowable expenditures to RCA for reimbursement.

RECOMMENDATION

We recommend that RCA establish home provider repayment plans that comply with contractual provisions and DWCCMHA instructions for repaying amounts due based on audits and cost settlements.

AGENCY PRELIMINARY RESPONSE

RCA concurs with the recommendation. RCA informed us that it has renegotiated payment plans that are in conformity with the latest DWCCMHA guidelines for the 11 homes addressed in the audit. RCA is in the process of reviewing the repayment plans for its other homes to ensure compliance with DWCCMHA guidelines. RCA's target date for completing this review is May 1, 1999. RCA will continue to monitor and aggressively collect outstanding cost settlements utilizing the new staff mentioned in RCA's response to Finding 1.

RCA also informed us that the problem of cost settlement will disappear in time because RCA has changed to a fee for service contract, which does not require the type of cost settlement activity used prior to fiscal year 1996-97. This will end the need for this type of collection procedure as provider services are monitored for the fees paid by RCA.

EFFECTIVE AND EFFICIENT USE OF STATE FUNDS

COMMENT

Background: Community placement in a residential home is a cost-effective and an efficient means of care and treatment for recipients when compared to the alternative of inpatient psychiatric hospitalization. RCA's records show that it costs approximately \$134 a day to house and treat recipients in its homes as compared with approximately \$230 a day for treatment at a local State psychiatric hospital.

Audit Objective: To assess whether State funds were used effectively and efficiently in the purchase and delivery of specialized residential services.

Conclusion: We concluded that State funds were not used effectively and efficiently in the purchase and delivery of specialized residential services for the 11 homes that we reviewed. Our assessment disclosed two material conditions. RCA did not review the subcontracts entered into by its home providers for specialized residential services to determine that the subcontracts were appropriate and complied with RCA requirements. Also, RCA was not effective in detecting erroneous financial reporting by home providers contracted to deliver specialized residential services.

FINDING

3. Subcontracting of Specialized Residential Services to Related Parties

RCA did not review the subcontracts entered into by its home providers for specialized residential services to determine that the subcontracts were appropriate and complied with RCA requirements. As a result, home providers entered into related party subcontracts that provided them and their subcontractors with excessive administrative fees not allowed under the RCA home provider contracts.

RCA's home provider contracts require that home providers obtain RCA's approval before subcontracting home provider responsibilities. Failure to do so constitutes grounds for contract termination. Also, the contracts stipulate that a home provider's level of reimbursement for administration is limited to 9.9% of the amount it spends for direct care, operations, equipment, and resident allowances.

We reviewed the financial and incorporation records for 11 residential homes for fiscal year 1995-96. Four of the 11 homes subcontracted \$1,056,924 (86%) of the \$1,230,535 in specialized residential services provided for in the RCA home provider contracts to 3 related party corporations and companies without RCA's approval. The subcontracted services included direct care staffing, residential home leases, home maintenance, food and supplies, recipient transportation, and equipment leases. We determined that officers and registered agents of each of these 4 residential homes were also officers, registered agents, or owners of the 3 subcontractors (see Exhibit 2). We also identified 5 subcontracts entered into by 3 of the homes with 2 subcontractors in which the same individual signed the contract as both the contractor and contractee. We conclude that these subcontracts were less than arm's-length transactions and were entered into for the purpose of obtaining greater compensation than allowed for by the home provider contracts.

We analyzed the payroll records of the one subcontractor that provided direct care staffing to all 4 homes to determine the extent that administrative fees exceeded the 9.9% limit stipulated in RCA's home provider contracts. The following table shows that the subcontractor's administrative fees accounted for \$455,111 (54%) of the \$845,415 in contract costs:

Excessive Administrative Fees Paid to Related Party Subcontractors

Home	(1) Amount of Direct Care Staffing Subcontract	(2) Subcontractor's Direct Care Worker Payroll Costs*	(3) Excessive Administrative Fees (Column 1 Less Column 2)	(4) Percentage of Subcontract Attributable to Excessive Administrative Fees
4	\$304,868	\$128,798	\$176,070	58%
5	184,312	100,470	83,842	45%
6	175,082	98,055	77,027	44%
7	181,153	62,981	118,172	65%
	<u>\$845,415</u>	<u>\$390,304</u>	<u>\$455,111</u>	54%

* Actual payroll costs plus estimated fringe benefits.

As required by RCA's home provider contracts, RCA paid the home providers \$83,696 (9.9% of the \$845,415) in compensation as administrative fees in addition to the \$845,415 for direct care staffing at the 4 homes. However, as the preceding table illustrates, the home providers and the related party subcontractors earned a combined total of \$538,807 (\$83,696 for the home providers plus \$455,111 for the subcontractors) or 64% ($\$538,807 \div \$845,415$) in administrative fees. This percentage of compensation violated RCA's home provider contracts.

RCA management was aware of these subcontracts but did not take action to either instruct the home providers to end their contractual relationships with these other related party entities or terminate its home provider contracts.

RECOMMENDATIONS

We recommend that RCA review the subcontracts entered into by its home providers for specialized residential services to determine that the subcontracts are appropriate and comply with RCA requirements.

We also recommend that RCA seek to recover the excessive administrative fees paid to home providers and their related party subcontractors that were not allowed under RCA's home provider contracts.

AGENCY PRELIMINARY RESPONSE

RCA concurs with the recommendations. RCA informed us that it conducted meetings with the 4 affected home providers during January 1999 and offered them the opportunity to sever their related party subcontracts or face sanctions, including the non-renewal or termination of their agreements with RCA.

Also, each home provider executed a special conditions contract amendment for fiscal year 1998-99 that prohibits the subcontracting activities as noted in the audit. The amendment severs and prohibits any future related party transactions of whatever nature as of March 1, 1999. Each of the affected home providers has executed a financial repayment agreement that recaptures all excess administrative fees as referenced in the report.

Further, RCA's contract management staff has been instructed to review and reject any new or existing home provider applications that contain similar subcontract relationships.

FINDING

4. Home Provider Financial Reporting

RCA was not effective in detecting erroneous financial reporting by home providers contracted to deliver specialized residential services. As a result, home providers reported expenditures and received RCA funding for items that were not reimbursable under the terms of their contracts.

RCA's contracts with its home providers contained funding provisions using a reimbursement-for-cost methodology based on reported expenditures. As compensation, home providers received a fixed administrative fee percentage based on budgeted contract costs.

We examined fiscal year 1994-95 and 1995-96 financial and other records of home providers that operated 11 residential homes for a total reported cost of \$4,748,214. Our examination disclosed \$808,125 of undocumented and misrepresented expenditures by home providers that RCA did not detect:

a. Undocumented Expenditures

We identified 56 instances, totaling \$207,706, of undocumented expenditures reported for all 11 homes that RCA reimbursed. Examples of these undocumented expenditures include: \$8,827 for furniture and equipment, \$74,521 for food and supplies, \$12,517 for utilities, \$22,387 for home maintenance, and \$7,037 for unspecified credit card charges. RCA's contracts require home providers to maintain financial records, supporting receipts, and other documentation verifying expenditures.

b. Misrepresented Expenditures

We identified 34 instances, totaling \$600,419, of misrepresented expenditures reported for 7 of the 11 homes. Home providers appear to have deliberately

misrepresented these as allowable expenditures when they reported them to RCA for reimbursement. Examples include:

- (1) Vehicle lease payments that totaled \$5,091 for an administrative employee's personal car that home providers misrepresented as home transportation expenditures for three homes. Expenditures not related to operation of the homes were not reimbursable under the terms of RCA's contract.
- (2) Administrative wages totaling \$580,208 that home providers misrepresented as direct care expenditures. These wages were not reimbursable under the terms of RCA's contracts.

RCA lacked an effective monitoring system to help ensure that its home providers reported expenditures for reimbursement in accordance with RCA's contracts (see Finding 1). RCA management attributed this condition, in part, to insufficient funding from DWCCMHA to expand the number of contract managers beyond one or two positions to meet DWCCMHA's monitoring requirements. However, considering RCA's contractual obligation to meet DWCCMHA requirements and the home providers' history of reporting ineligible expenditures to RCA for reimbursement, reallocation of other staffing resources to contract manager positions should be made a management priority.

We conclude that routine monitoring should begin by comparing reported expenditures to budgets and investigating any significant differences. When deemed necessary, routine monitoring should also include verifying selected reported expenditures to invoices and other supporting documentation and reviewing payroll records. These additional procedures are especially important given the home providers' previous audit and cost settlement history. Routine monitoring would help detect many of the instances of erroneous financial reporting disclosed in this finding.

RECOMMENDATIONS

We recommend that RCA improve its efforts to detect erroneous financial reporting by home providers contracted to deliver specialized residential services to RCA recipients.

We also recommend that RCA seek restitution from home providers who inappropriately received reimbursement for expenditures that were not reimbursable in accordance with RCA's contracts.

AGENCY PRELIMINARY RESPONSE

RCA concurs with the recommendations. RCA informed us that it has hired new contract management staff and adopted new monitoring and desk audit procedures as indicated in response to Finding 1. These steps have materially improved RCA's ability to detect erroneous financial reporting. Also, DWCCMHA returning the financial audit function to RCA has further improved RCA's potential for uncovering erroneous financial reporting.

SUPPLEMENTAL INFORMATION

SPECIALIZED RESIDENTIAL SERVICES PROGRAM
OF RESIDENTIAL CARE ALTERNATIVES, INC.

Residential Home Provider Questioned Costs*
For Fiscal Years 1994-95 and 1995-96

<u>Home</u>	<u>Excessive Administrative Fees (Finding 3)</u>	<u>Undocumented Expenditures (Finding 4)</u>	<u>Misrepresented Expenditures (Finding 4)</u>	<u>Total</u>	<u>Percentage of Total Expenditures</u>
1	\$	\$ 13,448	\$ 119,347	\$ 132,794	27%
2		5,945	198,812	204,757	35%
3		4,727	130,459	135,186	27%
4	176,070	71,632		247,701	55%
5	83,842	47,902		131,745	46%
6	77,027	31,158		108,185	44%
7	118,172	28,988		147,160	58%
8		1,354	38,467	39,821	8%
9		260	37,690	37,950	9%
10		491	37,954	38,444	7%
11		1,801	37,690	39,491	8%
	<u>\$ 455,111</u>	<u>\$ 207,706</u>	<u>\$ 600,419</u>	<u>\$ 1,263,236</u>	27%

Source: The financial records of home providers and their subcontractors.

* "Questioned Costs" are defined as amounts potentially due to a contracting agency because of reimbursements for unallowable, undocumented, unapproved, or unreasonable costs.

SPECIALIZED RESIDENTIAL SERVICES PROGRAM
OF RESIDENTIAL CARE ALTERNATIVES, INC.
 Residential Homes With Related Party Subcontractors
As of September 30, 1996

Related Party	Related Party's Role in Residential Home Corporation				Related Party's Role in Subcontractor Business		
	Home 4	Home 5	Home 6	Home 7	Subcontractor I (A)	Subcontractor II (B)	Subcontractor III (C)
1. Corporation	Agent	Agent			Owner		
2. Individual	President	President			President		
3. Individual (D)			President	President		Owner	
4. Individual (E) (F)	Secretary	Secretary			Secretary		
5. Individual (F)	Secretary	Secretary	Agent (G)	Agent (G)			Agent

(A) This subcontractor provided general services, such as home leases, maintenance, food and supplies, recipient transportation, and equipment leases, to homes 4 and 5.

(B) This subcontractor provided general services, such as home leases, maintenance, food and supplies, recipient transportation, and equipment leases, to homes 6 and 7.

(C) This subcontractor provided direct care staffing services to homes 4, 5, 6, and 7.

(D) This individual signed home and equipment leases as both lessee and lessor for homes 6 and 7 and subcontractor II.

(E) This individual signed a home lease as both landlord and tenant for home 4 and subcontractor I.

(F) Individual 4 and 5 are the same person.

(G) Although not a registered agent, the individual signed contracts for homes 6 and 7.

Note: The term "Secretary", as used in the above table, refers to a corporate board officer.

Source: Articles of incorporation and annual reports on file with the Department of Consumer and Industry Services and contract information maintained by Residential Care Alternatives, Inc.

Glossary of Acronyms and Terms

case management services	Services that will assist the recipient in gaining access to needed medical, social, educational, and other services. These services include assessment, service plan development, linking and coordinating of services, and monitoring of services.
day program services	Services that provide planned and systematic sequences of training and therapy tailored to the recipient's needs, which are delivered in other than a residential or inpatient setting and with a frequency and duration that will improve the recipient's functioning in the community.
DCH	Department of Community Health.
developmental disability	A disability that becomes evident in childhood; is expected to continue indefinitely; constitutes a substantial handicap to the affected individual; and is attributed to mental retardation, cerebral palsy, epilepsy, or other neurological conditions.
Detroit-Wayne County Community Mental Health Agency (DWCCMHA)	DWCCMHA is an agency of county government and is subject to oversight by the Department of Community Health.
effectiveness	Program success in achieving mission and goals.
efficiency	Achieving the most outputs and outcomes practical for the amount of resources applied or minimizing the amount of resources required to attain a certain level of outputs or outcomes.

home provider	Individual, company, or corporation contracted to provide residential services in a residential home(s).
material condition	A serious reportable condition which could impair the ability of management to operate a program in an effective and efficient manner and/or could adversely affect the opinion of an interested person concerning the effectiveness and efficiency of the program.
mental illness	A substantial disorder of thought or mood which significantly impairs an individual's judgment, behavior, capacity to recognize reality, or ability to cope with the ordinary demands of life.
mission	The agency's main purpose or the reason the agency was established.
outpatient services	Mental health services provided outside an inpatient hospital setting. Services may include both case management and therapy.
performance audit	An economy and efficiency audit or program audit that is designed to provide an independent assessment of the performance of a governmental entity, program, activity, or function to improve public accountability and to facilitate decision making by parties responsible for overseeing or initiating corrective action.
questioned costs	Amounts potentially due to a contracting agency because of reimbursements for unallowable, undocumented, unapproved, or unreasonable costs.
RCA	Residential Care Alternatives, Inc.
recipient	An individual receiving mental health services.

Rehabilitation Accreditation Commission (CARF)	An organization that serves as the preeminent standards-setting and accrediting body. CARF (formerly known as the Commission on Accreditation of Rehabilitation Facilities) promotes the delivery of quality services to people with disabilities and others in need of rehabilitation.
reportable condition	A matter coming to the auditor's attention that, in his/her judgment, should be communicated because it represents either an opportunity for improvement or a significant deficiency in management's ability to operate a program in an effective and efficient manner.
specialized residential services	A combination of residential care and mental health services that is expressly designed to provide rehabilitation and therapy to a recipient, that is provided in the residence of the recipient, and that is part of a comprehensive individual plan of services.
supported employment services	A program that provides for job coaching, skills training, and in-house and community employment.